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عنوان البحث:

The impact of the global financial Crisis on the Takaful market
أثر الأزمة المالية العالمية على سوق التأمين التكافلي

Pr. AYEB Walidأ.عايب وليد	**Pr. BOUKHARI Lahlou** أ.بوخاري لحلو
أستاذ دائم بجامعة محمد البشير الإبراهيمي	أستاذ دائم بجامعة محمد البشير الإبراهيمي
برج بوعريريج -الجزائر-	برج بوعريريج -الجزائر-
البريد الالكتروني: ayebwalid@hotmail.com	البريد الالكتروني: lah.bouk@yahoo.fr

Abstract:

The purpose of this study is to identify The impact of the global financial Crisis on the Takaful market, To achieve this purpose، we We will take the basic concepts of Takaful

insurance, followed by Comparaison of conventional insurance and takaful, Then we review the challenges and issues facing the Takaful insurance industry, after that we address the impact of the financial crisis on the insurance industry in general, followed by the impact of the financial crisis on Takaful insurance industry. then we review the evolution of insurance markets in some Muslim countries after the global financial crisis, as a conclusion this study will introduce the Forecasts for Global Gross Takaful Contributions.

الملخص:

تهدف هذه الدراسة إلى معرفة أثر الأزمة المالية العالمية على سوق التأمين التكافلي، و لذلك سوف نقوم بالإحاطة بالمفاهيم الأساسية الخاصة بالتامين التكافلي، ثم نستعرض التحديات والقضايا التي تواجه صناعة التأمين التكافلي، بعد ذلك نتطرق إلى أثر الأزمة المالية على صناعة التأمين بصفة عامة يليها أثر الأزمة المالية على صناعة التأمين التكافلي، ثم نستعرض تطور أسواق التأمين في بعض الدول الإسلامية بعد الأزمة المالية العالمية، وفي الأخير تخلص الدراسة إلى التنبؤ بمستقبل صناعة التأمين التكافلي.

Introduction:

All human beings are invariably exposed to the possibility of meeting catastrophes and disasters giving rise to misfortunes and sufferings such as death, loss of limbs,

accident, destruction of business or wealth, etc. Notwithstanding the belief of all Muslims in Qadha-o-Qadr, Islam provides that one must find ways and means to avoid such catastrophes and disasters wherever possible, and to minimize his or his family's financial losses should such events occur.

Takaful, the Islamic alternative to insurance, is based on the concept of social solidarity, cooperation and mutual indemnification of losses of members. It is a pact among a group of persons who agree to jointly indemnify the loss or damage that may inflict upon any of them, out of the fund they donate collectively.

In this presentation, we will endeavour to assess the impact of the financial Crisis on the Takaful sector , according to this plan:

1- **The concept of takaful**
2- **Origin of takaful**
3- **Developpemnt of takaful**
4-Comparaison of conventional insurance and takaful
5-Challenges and issues that faced by Takaful industries
6- Impact of financial crisis on insurance industry
7-The impact of the financial crisis on the takaful markets
8- Evolution of Takaful Markets afetr financial crisis
9- Global Takaful forecast

1- The concept of takaful :

The concept of Takaful[1] is very wide and clear. The concept of Takaful is to protect the human being especially, when they are harm. It is nature, when one person is harm or in danger, the rest of people will help that person who suffering the loss. Besides, it seems that every person take care about others. Such a feeling of responsibility is being reinforced by the Islamic teachings as found in the following injunctions:
SWT precisely explains in the Qur'an the human being should help each other when they are in danger or need help. And there are a lot of verse in Qur'an that encourages human being to help each other, these verse are**, *Surah Al-Maidah*** (5): 3 ,**Surah Al-Maidah** (5): 3 Essentially Takaful is a cooperative insurance where members are those who face the same risk or danger of incurring losses and who willingly contribute a certain sum of money which will be used to compensate those members of the group who incur such losses. As in the case of ancient Arab tribal custom, every member of the tribe faces the same danger of being inflicted harm by another tribe which is at war with them.

Takaful is not only concern to protect individual or one's own life, it is based on to protect and help in whole society especially, those who are suffering from financial problems. It is one of the means of providing a material safeguard for offspring and is thus in line with the saying of the holy prophet SAW. He (SAW) spoke to this effect: "it is better for you to leave your off-spring wealthy than to leave them poor, asking others for help". The Holy Prophet (SAW) also encouraged the providing of security for the widows and poor persons as he highlighted in one of his traditions: "The one

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[1] Takaful is derived from its Arabic root word "*kafala*" which literally means "to guarantee". In terms of usage and implication, the term "*kafala*" certainly denotes the agreement by one party to Indemnify another for any liability that has been pre-agreed upon.

who looks after and works for a widow and for a poor person (dependent), is like a warrior fighting for The Cause of Allah (SWT), or like a person who fasts during the day and prays throughout the night.[2]

2- Origin of takaful:

The concept of takaful, or Islamic insurance, has been familiar for centuries and was practiced by the Muhajirin of Mecca and the Ansar of Medina following the Hijra of the Prophet Muhammad over 1400 years ago.

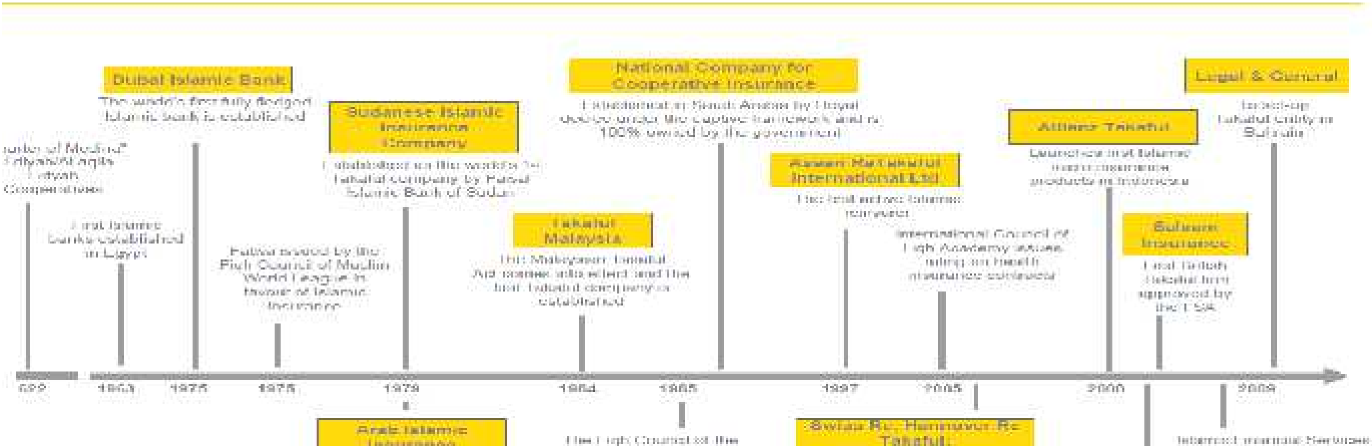
Takaful derived from the *'aqilah* and *diyah* systems, whereby people of a given tribe would come to the financial rescue of one of its members should he face an unexpected liability, such as paying for blood money.

3- Developpment of Takaful:

In modern-day contexts, the first *takaful* company - the Islamic Insurance Company of Sudan - was founded in Sudan by the Faisal Islamic Bank in January, 1979 (Anwar, 2008). The Bank's *Shari'ah* Supervisory Board approved this endeavour, and in January 1979, the Islamic Insurance Company was established as a public company (under the *Companies Act*, 1925). In Malaysia, the Islamic Insurance Company was established as a private limited company. The Malaysian government took steps to form a special body known as a "Task Force" on the establishment of Islamic insurance in Malaysia. In its report to the government, the task force suggested that an Islamic insurance company should be established in Malaysia. The Malaysian government then promulgated legislation known as the *Takaful Act*, 1984, which regulates the Islamic insurance (*takaful*) of Malaysia (Ali, 2008).
In 1985, the Council of Islamic Scholars in Mecca approved *takaful* as a *Shari'ah*-approved alternative to the conventional insurance system. This led to mutual *takaful* companies being established in different Muslim countries, including Dubai, Bahrain, and Malaysia
(Anwar, 2008).

In the Middle East, *takaful* has developed in Saudi Arabia, Bahrain, Iran, and Qatar, with new operations recently opening in Egypt, the United Arab Emirates, and Kuwait. Steps have also been taken in Europe and the US to establish similar companies. There are no doubt that there are tremendous opportunities for *takaful* in those Western countries harbouring large Muslim communities. As such, the potential for *takaful* is enormous. Currently, Malaysia has the most mature *takaful* businesses operating alongside conventional banking and insurers.

Figure 01: Development OF Takaful



Source: **The World Takaful Report 2012 ,** Opportunities in adversity - the future of Takaful, DUBAI, April 2009, p 07.

4-Comparaison of conventional insurance and takaful

conventional insurance	takaful
A risk transfer mechanism whereby is transferd from policy holder – the insured- to the insurance company- ths insurer- in consideration of an 'insurance premium' paid the insured.	Based on mutality; hence the risk is not transferd but shared by the participants, who form a common pool. The company – takaful operator- acts only as the manager of the pool. In effect, the policyholders are both the insurer and the insured.
Contains the element of uncertainty, i.e. Gharar, which is forbidden in islam. The terms of contract are unclear as to certainty of when any loss would occur and how much compensation would be payable.	The element of uncertaintly, i.e, gharar, is brought down to acceptable levels under shariah by characterizing contributions as donations- tabarru' - , not obligation and for a good cause,i.e, to mitigate the loss sufferd by any one of the participants, as opposed to payments linked to definite excpectaion of insured benefits to be received.
Contains an element of gambling, i,e., Maisir, in that the insured pays an amount – premium- in the expectation of gain – compensation/ payemant against claim- . if the anticipated loss- claim- does not occu, the insured the amount paid as premium. If the loss does occur the insurer loses a far laregr amount than collected as premium and the insured gaind by the same.	The participant pays the contribution – Tabarru'- in the spirit of ne'ea –purity- and brotherhood to cover mutual losses of members of the pool. Losses and gains are mutually shared by the pool members who contribute to the pool. That is, third parties – insurers or reinsurers- are not affected by the outcome of risk events.

Funs are mostly invested in fixed interst-boarding instruments as bonds , fixed interst securities, etc, hence these contain the element of riba- Usury-, which is forbidden in islam.	Funds are bot invested in non-interest-bearing, i.e, Riba free, instruments are still possible – such as undr sukuk, Islamic bonds- as long asincome is not inerest based.
Surplus or profit belongs to both the shareholders and the with-profit policyholders, the insured is coverd during the policy period but is not entitled to any return at the end of such period.	Surplus belongs to the participants and is accordingly returned to them.

Source: Safder Jaffer and others, **Takaful – Islamic Inssurance- concept, challenges, and opportunities,** Milliman research report, Seattele, November 2010, p 06**.**

5-Challenges and issues that faced by Takaful industries:

There are few challenges and issues that mainly faced Takaful industry especially when they are operating within a dual banking and insurance regime. Some of the challenges are as follows :

- **Challenges Awareness** – It is required from All Islamic Financial Market Players to establish Islamic Finance Awareness as a "Cause" with dedication & commitment. Re-Takaful Capacity – Takaful entry to bigger & complex Risk is highly dependant on Re-Takaful Operators' capacity which is very limited compared to Conventional Re-insurers Skilled Human Resource – Takaful Industry's rapid growth is not backed by required technically skilled Human Resource
- **Challenges Product Development** – New and innovative products meeting participant's requirement need to be developed Investment Options – Investment options in accordance with Shariah principals are limited Regulatory Framework – The establishment of International standards for Takaful would allow consistency in regulation across jurisdictions.[3]
- **Development of human resource:** there are less people who have mainly understood the concept of Takaful. There is shortage of human skill that regarding or have no enough knowledge, experience about Takaful. Progress is being made in some regions currently. But it is not widely solved because of small number of people have knowledge about Takaful. However, it's more appropriate to have great people or scholars who have knowledge and understand the concept of Takaful in Islamic way of method.
- **Regulatory framework** One of the serious challenges that Takaful face mostly is regulatory framework, to establish a suitable framework is usually takes long

[3] Imtiaz Bhatti MD, **Challenges & Issues Faced by Takaful Industry**, 3rd International Conference and Exhibition on Islamic Banking and Takaful , 2nd Nov 2009.

process and sometimes it happed that the scholars will not agree each other. So in order to place Takaful in good place, it is appropriate that all the scholars should take the responsibility to regulate and supervise all the framework of Takaful. In some countries there is dual financial system, so that statutorily required of the conventional financial system such as good governance, compliance of regulations and other provisions should also be applicable to the Islamic financial system. In some reason of Takaful, the legislative may require a minimum solvency margin in order to impose on conventional insurers should also be applied to Takaful. Such requirement can only be effected by law. With a proper legislative framework, it would also enable the authority to regulate whole gamut.

- **Solvency and capital requirement**: Since most of framework is based on local approaches that mainly believed by the local scholars in a particular region especially level “playing field” have some similarities to the conventional insurances. Therefore, there could be challenges that can face the insurance or takaful. These challenges could be:

for regulatory regimes it is hard to give more consideration to interest free loan or what to call Qard in order to know the solvency requirement for Takaful companies

attention to whether the level playing field can stay in long term for Takaful

Giving priority to the surplus distribution and contingency reserve approaches, which may be cause in a lower capital requirement for Takaful entities.

Consideration to the treatment and approaches of rating agencies towards Takaful entities [4].

6- Impact of financial crisis on insurance industry:

- **Financial crisis will wipe out some insurance companies, predicts E&Y:** Several insurance firms will fall victim to the global financial crisis, Robert Stein, global director of actuarial services for Ernst and Young, predicted. However, with many specialists suggesting there will be no end to difficult economic conditions in the near future, the insurance industry will not escape untouched. Stein says there will be a need for consolidation within the, industry, and warns that some smaller companies will not make it through the financial turmoil. "Weaker companies in the insurance industry will not survive and we will see increased consolidation," Stein said, speaking on an Ernst and Young webcast titled Credit crisis and the insurance industry (reactionsnet.com).
- **The global financial crisis will not bring about an end to insurance:** Wiggle Managing Director of Linkage Assurance thing is certain, the role insurance really plays is to protect against economic waste. We cannot say because there is downturn, there will be no insurance. Insurance will still take its rightful place. Those that insurance protects still exist”. As long as the assets to be insured are still in existence, there will still be insurance. The only area it will affect insurance is the investment aspect of insurance," he stated predicting that "insurance income will drop but marginally". But for investment income, he

[4] Abdirahman Sh. Mohamed Omer, **op-cit, p 6-10.**

says the decline has become obvious and will impact on risk price calculation for insurers who are responsive.

- **Claims tend to increase:** The default from the borrowers will increase the claim amount. As the financial crisis is deepening, more banks and financial organizations and manufacturing units will face crisis or closures which will affect the insurance industry.
  reinsurance market say the financial crisis will increase the demand for reinsurance, given the erosion of many insurers' capital
- **Decrease in Investment Income:** The financial crisis has decreased the investment income of insurance companies. The following table shows the downfall in various

stock markets of the world.

- **Insurance price will increase:** The insurance prices are expected to increase due to financial crisis which has eroded investment income as a consequence of stock market crash the world over. The insurers and re-insurers try to augment their losses in investment income through right pricing. This is because investment is an integral companies had grown their assets on quoted stocks and therefore could afford to subsidize their prices, Joe
- **Decline in new businesses:** World economy has entered a recession. Economic activities have declined. General Motors in America has retrenched 25% of its employees. Many construction projects in Dubai have employees. Many construction projects in Dubai have been stopped. These will finally result in reducing new business for insurance companies.
- **Reinsurance rates will Increase:** The fall in investment income will increase the cost of insurance and reinsurance.

In this environment, insurers and re-insurers are expected to maintain strict underwriting discipline and a cautious, Asset Liability Management (ALM) driven investment profile in order to preserve their capital base. Hardening rates, especially in commercial lines, should help companies navigate through the credit crisis induced turmoil. The financial crisis is expected to encourage insurers to remain strictly focused on their core business of risk underwriting.

In 2009, Russian insurance companies aren't likely to post a rapid increase in premiums due to the global financial crisis, said Ilya LOMAKIN-ROUMYANTSEV, head of the Federal Service for Insurance Supervision (FSIS), on October 9 at the press conference "Insurance Market: Public Policy and New Development Frontiers". Lomakin-Roumyantsev believes that insurers have to take into account the possible premium decrease of up to 25 - 30% when drawing development plans for the next year. He estimated that in the worst-case scenario the market may see a 50% drop in premiums (insurance.
1asig.ro).[5]

6-The impact of the financial crisis on the takaful markets

The possible impact on takaful

[5] SK Sinha and Zaid Ahmad, **Global financial crisis - with special reference to insurance industry**, Ansari Department of Financial studies VBS Purvanchal University Jaunpur (UP), India. Accepted 8 October, 2009, p 187-188.

Takaful companies are not immune to the current economic crisis as they are part of the global insurance industry and because they are relying on the global reinsurance pricing. because they are relying on the global reinsurance pricing. because they are relying on the global reinsurance pricing. The negative impact is likely to be felt on two levels. At the first level, the collapse of stock exchanges and the drop in the investment returns will negatively impact shareholders of takaful companies, and the fact that Shariah standards separate policyholders from shareholders' accounts, will see them incurring losses without being able to benefit from underwriting profits, which are exclusively and legitimately the property of policyholders. Therefore, this crisis must make us reconsider the distribution of profits among shareholders and policyholders, otherwise, the risk is to lose potential investors who could have established takaful companies.

The drop in the investment returns would negatively impact on the policyholders' fund, and they may lose additional income which could help them to carry insurance or have some pricing flexibility, and face the gradual continued drop of insurance premium rates especially in the Gulf region .

At the second level, although the impact of the recession will affect takaful, this impact would be limited because takaful companies are based only in Southeast Asia and Arab Gulf countries.

The fact that a large number of companies are located in GeC countries enables them to benefit from the economic boom that Gulf countries witnessed in recent years and which will continue, thanks to the oil income and investment in infrastructure projects.

The pace of growth in the insurance sector in GeC and Iran in the recent period exceeded 25% in some countries; in other Muslim countries in Southeast Asia, the growth was lower. In Africa, the economic growth and the emergence of a middle class needing housing or life and property insurance is boosting insurance demand. However, this growth cannot hide the fact that insurance penetration for both conventional and takaful is still very low. The highest insurance penetration rate for an Islamic country is Malaysia with 5% in the GDP.

Positive effects:

In view of recent trends, there are some positive sides of the crisis. There is an increase in the demand for credit insurance in view of the fears of bankruptcy of the financial institutions and corporate clients; and this increase is supposed to increase rates for export credit insurance. The Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC)will be one of the beneficiaries.

Secondly, the AIG crisis situation may encourage international insurance companies to adopt conservative ones. This is likely to raise rates in almost all lines of business to compensate investment losses and to protect companies from markets fluctuations.[6]

Thirdly, the current financial markets collapse will oblige insurance companies to reconsider their strategy and go back to their "core business" which is underwriting risks instead of investment and speculation.

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[6] Chakib Abouzaid, **Impact of the current global crisis on Islamic institutions and takaful Companies**, Article from : http://www.meinsurancereview.com/pages/simple_search.asp.

Do all these potential positive impacts affect takaful industry? As mentioned earlier, the takaful industry is a part of the global insurance industry and, therefore, will be affected as negatively or positively as conventional companies. We, therefore, expect that international reinsurers will implement more discipline in pricing which should have a positive impact on Muslim markets, which will benefit takaful insurance companies directly.

Looking at the takaful map, we can observe that we are theoretically outside the areas that are affected more by the current crisis (ie North America, Europe, Japan and Korea). The incorporation of more than 140 takaful companies in Muslim countries largely protects them from the direct impact of the financial crisis. Therefore, the current growth rate of 28% in recent years may continue. This optimistic outlook is because takaful companies are young, and not being large, their flexibility to face the crisis is very high in view of their investments in Islamic instruments exclusively. Moreover, takaful companies provide insurance for segments or customers looking for Shariah compliance.

Last but not the least, most of the newly established companies in Muslim countries are takaful, and the launch of new companies should continue, thanks to the dynamism and vitality of Islamic banks.

Takaful companies can benefit from short-term deposit returns due to their business models (funds segregation) and prudent investment policies, especially when investing policyholders' funds. They can also benefit from the recovery of sukuks and stock markets.

Impact on takaful

As mentioned earlier, the impact of the crisis will be limited to short-term investment profits.However, the impact in the medium and long terms must be positive in terms of rates, thanks to the hard market and underwriting discipline. More importantly, the financial system failures and the uncertainty about its ability to create wealth from speculation should boost the Islamic financial banking model.

As part of the Islamic financial system, takaful must benefit from this new situation by differentiating itself from traditional business insurance, and must improve its services and products.[7]

8- Evolution of Takaful Markets after the global financial crisis :

With the global financial crisis raging, Islamic finance seems to have been relatively unscathed. Takaful still remains a viable option, if not a more attractive option now for both Islamic as well as conventional clients.

This assertion is valid for both core Takaful markets: South East Asia and Middle East.

Takaful seems to have become a fundamental part of the insurance landscape and is growing from strength to strength, within the region and internationally with more players sprouting up even in the West and North America.

This is a continuation of the strong trend that has taken shape in recent years

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[77] Ibid .

and a testimony that there is ample opportunity for growth in a dynamic and underserved market.

Overall, the industry recorded a strong performance in the first 3 quarters with some corrections in the 4th quarter 2009.

• **Malaysia:** continues to be the leader showing a strong performance especially on the family Takaful front where contributions grew by 20% to about US $800 M(US$ 672 million in 2008) representing 11% market share of Malaysia's total Life business Two new licenses for foreign operators are in the process of being granted In South East Asia.

• **In Indonesia,** Takaful contributions stood at US$ 194.1 million as of Sept. 2009. i.e. 2.83% of the total insurance premium. segment has attracted several foreign companies (Prudential, Allianz, ManuLife Financial Corp. and AXA) Family Takaful accounts for 3.2% of the Life market (against 2.1% in 2008).

Takaful industry is "bucking" the trend in the broader economy and continues to grow at a healthy pace.

The leading Takaful firms in Saudi Arabia, the UAE and Bahrain have performed relatively well, while those in Kuwait have had a somewhat challenging year in 2009.

• In **Egypt**, two new Takaful companies started their operations as from 1st Jan. 2010 (Nile Family Takaful and Nile General Takaful) showing investors' keen interest in the sector.

In **Pakistan**, Bancassurance (six full fledged Islamic banks + 12 conventional banks with Islamic windows) seems to be making good inroads as an efficient distribution channel for Takaful products.

Specific guidelines for Bancassurance were introduced by the Securities and Exchange Commission of Pakistan (SECP) effective 30 April 2010.

• In **India**, the State Bank of India (SBI) and Life Insurance Corporation (LIC) are looking to launch Shariah compliant products, particularly Takaful (feasibility study under way).[8]

Over all, The Takaful industry continued to show double digit growth in 2011 albeit at a relatively slower rate of 19% as compared to previous years.

Amongst key markets, Malaysia and UAE again achieved growth rates of over 24%, whilst Saudi Arabia saw its gross contributions increase by US$0.5b. The challenge was once again, maintaining growth with profitability in the current economic climate. There were positive developments in the GCC with more operators showing profitability than previous years. The Saudi Cooperatives continued their growth performance yet still struggled in generating shareholder returns. Overall, return on equity for the Takaful industry was lower than conventional counterparts, both in the GCC as well as in Malaysia. However, a significant contributing factor to this was the lower investment returns for the industry relative to returns yielded by conventional insurers. The industry has now obtained significant market share versus conventional insurance in most GCC countries as well as South East Asian markets. There are a number of drivers behind this growth but one that is becoming increasingly important is regulatory support through appropriate amendments in legislature to provide a level playing field with conventional insurance companies.

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[8] Saleh J. Malaikah, **The Takaful Industry Today Where do we stand? What Next?** The 5th World Takaful Conference12-13 April 2010 Dusit Thani Dubai, UAE, p 13_ 20.

9- Global Takaful forecast

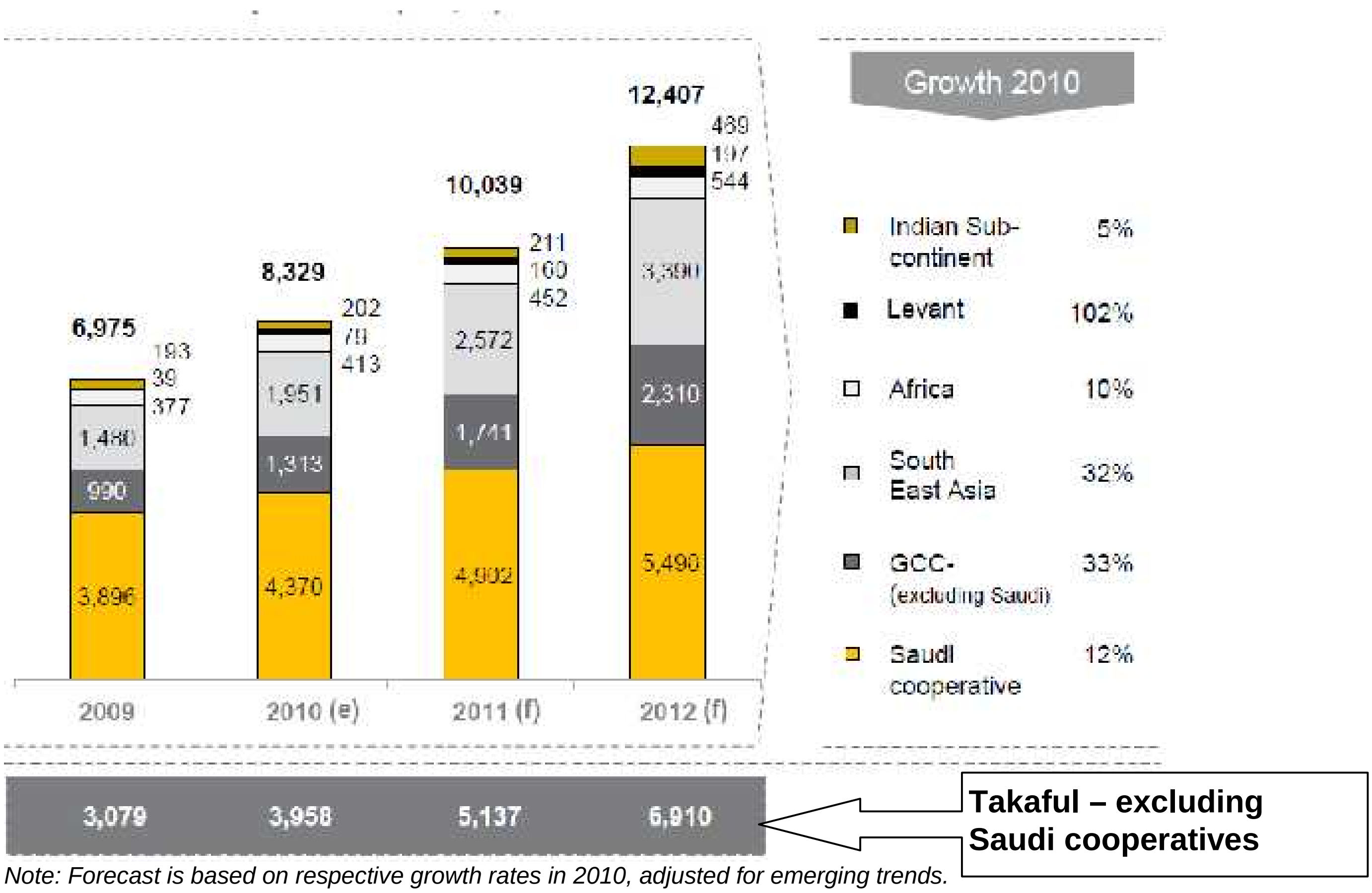
Continued steady growth in core markets and the emergence of new fringe markets such as Indonesia, Brunei and Bangladesh suggest a US$12b industry by 2012.

Global gross Takaful contributions reached US$8.3b in 2010 and continue to depict healthy growth. US$4.3b of these contributions came from Saudi cooperatives.

Current growth trends would suggest US$12b in gross contributions by 2012.

Excluding Saudi cooperative contributions, total Takaful contributions are expected to be reach US$7b by 2012.[9]

Figure 02: Forecasts for Global Gross Takaful Contributions – including cooperatives (US$m)



Note: Forecast is based on respective growth rates in 2010, adjusted for emerging trends.

Source: **The World Takaful Report 2012 ,** Industry growth and preparing for regulatory change, DUBAI, **April 2012, p 14.**

A remarkable resilience:

Broadly speaking, despite some impact on the short-term performance due to the financial crisis (and mainly on the investment side), the Takaful industry showed a remarkable resilience.

• While there are reasons to remain cautious about growth in the near term, Takaful is expected to grow faster than GDP for the foreseeable future Key Growth Drivers Still There.

• The main reason behind this is the fact that key growth drivers are still there:

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[9] **The World Takaful Report 2012 ,** Industry growth and preparing for regulatory change, DUBAI, April 2012; p14.

– Favourable demographics
– Increasing affluence
– Regulation
– Growth in Islamic finance
– Latent and inherent demand for Shariah compliant Products Favourable Demographics.
• Favourable demographics in core Takaful markets in South East Asia and the Middle East:
– Young and rapidly growing population.
– Significant decline in mortality rates.
– Improvement in average life expectancy.
• Increasing affluence :
– An expanding middle class potentially able and willing to insure (in all core Takaful markets).
– This is true for all core Takaful markets in South East Asia and the Middle East...
– But more specifically for the GCC...
– In the GCC the overall income levels of
– The average per capita GDP is expected to grow at CAGR of 7.4% in 2009-2012 (IMF)[10]

Conclusion:

Despite some impact on the short-term performance due to the financial crisis (and mainly on the investment side), The Takaful industry continued to show double digit growth after the financial crisis; Continued steady growth in core markets and the emergence of new fringe markets such as Indonesia, Brunei and Bangladesh suggest a US$12b industry by 2012. Takaful is expected to grow faster than GDP for the foreseeable future Key Growth Drivers Still There. Th last global financial crisis showed that takaful can be marketed for both Muslims and non-Muslims; It seems probable that takaful companies will attract new clients from the existing conventional insurance franchises after its performance and high levels of growth .

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[10] Saleh J. Malaikah, **op_cit**, p 21_23.

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